
# 1987 ANNUAL REPORT

## FINANCIAL HIGHLIGHTS

(000's omitted, except per share data)

| Year Ended 30 June | 1987 | 1986 | 1985 |
|---|---|---|---|
| Net Sales | **$806,700** | $ 889,300 | $ 883,100 |
| Net Income (Loss) | **$ 28,600** | $(127,900) | $(113,900) |
| Per Share Data | **$ 0.89** | $ (4.08) | $ (3.66) |
| Shareholders' Equity | **$145,000** | $ 105,000 | $ 222,500 |
| Average Shares Outstanding | **32,144** | 31,278 | 31,142 |
| Quarterly Per Share Data | | | |
| 1st Quarter | **$ 0.12** | $ (1.25) | $ 0.90 |
| 2nd Quarter | **$ 0.68** | $ (1.70) | $ 0.10 |
| 3rd Quarter | **$ 0.03** | $ (1.17) | $ (0.67) |
| 4th Quarter | **$ 0.06** | $ 0.04 | $ (3.99) |
| Total | **$ 0.89** | $ (4.08) | $ (3.66) |

## COMPANY DESCRIPTION

*Commodore International Limited is a fully integrated manufacturer of advanced microcomputer systems, semiconductor components, and consumer electronic products. Manufacturing facilities are located in North America, Europe and the Far East. Marketing is worldwide. Research is devoted primarily to the development of new products using solid state integrated circuitry, computer technology and consumer electronics.*



## CONTENTS

## TO OUR SHAREHOLDERS:

In fiscal 1987 Commodore International returned to profitability and took important steps toward renewed sales growth. Management enhanced the Company's operational efficiencies, improved its balance sheet, strengthened its sales and marketing operations, and in the fourth quarter introduced new computers that will provide a gateway to expanded markets and sales revenues in the year ahead.

Net profit for fiscal year 1987 was $28.6 million compared with a net loss of $127.9 million in fiscal year 1986. All four profitable quarters showed positive earnings comparisons to previous year quarters. Earnings for fiscal 1987 were $0.89 per share.



Net revenues for fiscal year 1987 were $806.7 million compared with $889.3 million the previous year. In the Commodore Amiga and PC-compatible product lines, CPU unit sales increased 100 percent and 76 percent, respectively, versus a year ago. CPU unit sales in the Commodore 64/128 product line decreased 30 percent versus a year ago.

Commodore International's operations outside of the United States accounted for 74 percent of fiscal 1987 sales revenues. While the Company is restructuring its U.S. sales and marketing operations and its methods of distribution for increased sales, its markets outside the United States will continue to make an important contribution to the Company's near-term future.

Operating expenses were 20 percent of sales revenues in fiscal 1987 compared with 27 percent in fiscal 1986, a reduction achieved through operating efficiencies implemented without sacrifice to our aggressive new product and marketing efforts.

## PRODUCTS

Toward the close of the 1987 fiscal year, the Company launched two new computers: the Commodore Amiga 2000 for business and professional applications and the Commodore Amiga 500 for the home and education sectors.

The Commodore Amiga 2000 has been introduced as the price/performance leader in business/professional systems with unique applications in desktop presentation, including publishing, graphics, and video, and in computer-aided design and other advanced graphics applications. In scientific environments, the Commodore Amiga 2000 can function as a stand-alone persona[1] workstation and as a terminal in high-end workstation networks.

For sophisticated home and educational applications, the Commodore Amiga 500 also meets attractive price/performance standards. Its video, sound, and graphics capabilities make it an all-in-one information, productivity, and entertainment system.

Both the Commodore Amiga 2000 and the Commodore Amiga 500 offer multi-tasking, advanced graphics, video, four-channel sound, and built-in speech synthesis. Market response to both new computers has been strong. These products will provide a solid platform for sales growth in the coming year.

Outside the United States, Commodore introduced the PC40, a PC AT-compatible computer with a 40-megabyte hard drive, increasing speed and storage capacity. This new entry found immediate market demand, increasing the already strong share held by the Commodore PC line in the business sectors of many of Europe's national markets. Commodore expects to continue to provide MS-DOS PC products wherever market opportunities present themselves.

Following the success of the Commodore 128D in Europe, the Company introduced this computer in the United States late in fiscal 1987. A professionally oriented system with integrated disk drive and detachable keyboard, the Commodore 128D attracted new users in the United States, while in Europe, sales for this product continued to be strong. Packaged in certain national markets with "windows-and-icons" software, the Commodore 64 has been sold this year with new peripherals, increasing speed and performance. The size and global scope of the installed user base for the 64/128 product line—some 7 million worldwide—reflects its continuing success.

## MARKETING

Commodore's European operations have proved that marketplace relationships are as important to business success as price and performance. Building for continued sales growth, Commodore has continued to open new distribution channels and enter new markets worldwide. In the United States, the Company has begun restructuring its distribution base—adding mass outlets for its Commodore 64/128 product line and building a network of specialty computer resellers for the Commodore Amiga line, while strengthening the quality of its dealer base, increasing the number of service locations, and enhancing its support programs for independent developers, resellers, and end-users.

## MANAGEMENT

Worldwide, the Company took decisive steps to improve and strengthen its management in fiscal 1987 by appointing new general managers in Canada, Italy, France, the United Kingdom, and the United States. The Company expects to

continue to reappraise the performance of every Commodore manager at every level in terms of both operating results and cost-effectiveness.

## FINANCIAL

Shareholder equity increased $40 million during fiscal 1987 to $145 million at June 30. Profitability in the final quarter of fiscal 1986 and in all four quarters of fiscal 1987 has contributed to the strengthening of the Company's balance sheet. Year-end working capital was $196 million in fiscal 1987 compared with $132 million in fiscal 1986. At June 30, 1987 the Company's cash position was $49 million compared with $32 million at June 30, 1986. Year-end inventories were reduced from $202 million in fiscal 1986 to $193 million in fiscal 1987.

In May the Company completed a financing with The Prudential Insurance Company of America, comprised of $20 million senior notes and $40 million subordinated notes with warrants for 2,250,000 capital shares. In addition, during fiscal 1987 the Company repaid $68 million of the debt held by its major bank lenders.

## CONCLUSION

In the short span of the last ten years, microcomputer technology has taken a significant place in society, and its potentials have barely been tapped. Each year bears new applications, ranging from desktop video and local area networking to compact-disk interaction and worldwide telecommunications.

Since its entry into this industry in 1976, Commodore International has pursued one mission: to provide better technology at a better price. That mission reflects the dynamics of our industry, and the Company's success closely parallels our ability to fulfill that mission.

With the positive earnings achieved in five successive quarters through the fourth quarter of fiscal 1987, Commodore International has improved its financial position, enhancing its ability to expand its product lines and strengthen its marketing effort. Combined with a lean and strong management and a continued drive toward cost efficiencies, the momentum generated this year will help the Company move forward in its markets and continue to improve shareholder value in the year ahead.

Irving Gould

Irving Gould
Chairman of the Board
and Chief Executive Officer
September 30, 1987

***Pictured left to right are the world's most popular personal computer, the Commodore 64, and the world's first multi-tasking personal computers, the business-oriented Commodore Amiga 2000 and the consumer-oriented Commodore Amiga 500.***



## MAKING AND MARKETING THE MULTI-TASKING MICROS: COMMODORE IN 1987

Since entering the microcomputer industry in 1976, Commodore International Limited has pursued one mission: to provide better technology at a better price. The achievement of that mission is nowhere more clearly evident than in the new Commodore Amiga computers. Distinguished by multi-tasking, open architecture, and advanced graphics, the Commodore Amiga line is today's price/performance leader in the personal computer market.

## INTRODUCING BREAKTHROUGH TECHNOLOGIES

The new Commodore Amiga models, both introduced in the last quarter of fiscal 1987, are aimed at distinctly different users. The Commodore Amiga 500 is targeted at the home and education sectors. The Commodore Amiga 2000 is positioned for business and professional users. Both run the more than 700 software programs written for the Commodore Amiga operating system. Both are expandable up to a maximum of 9 megabytes, are multi-tasking, and feature a window-oriented user interface.

The Commodore Amiga 2000 features open architecture, which allows extensive internal expansion with multi-processor, multi-DOS options. MS-DOS PC compatibility provides access to the vast catalog of information-processing software currently in use by the worldwide business community. Running at the same speed as PC XT computers, this Commodore computer is also compatible with a variety of IBM hardware add-ons.

Offering a palette of 4,096 colors, IFF file standards, multi-tasking, speed, open architecture, and PC compatibility, the Commodore Amiga 2000 sets new standards in personal computing. It excels in graphics-oriented computing and is a leading force in the emerging market of "desktop presentation."

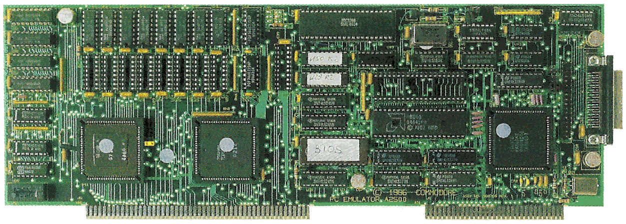
Software developed for the Commodore Amiga 2000 makes it the first and only personal computer that can produce four-color separations for magazine-quality desktop publishing. It interfaces with PostScript laser printers and Linotronic phototypesetters, and its 16 on-screen gray scales closely simulate true WYSIWYG—"What you see is what you get." The Commodore Amiga 2000 also breaks new ground in presentation graphics, including slide generation, transparency production, electronic blackboards, and photodigitizing. Beyond that is the world of desktop video with genlocking, real-time frame capture, titling, animation, and built-in NTSC-compatible or PAL-compatible output. Offering the future today, the Commodore Amiga 2000 offers a total solution for desktop publishing, presentation graphics, and desktop video.

Many of these same capabilities make the Commodore Amiga 2000 a low-cost, high-power graphics workstation for scientific and engineering applications. The CAD/CAE market, which has been estimated to grow 30 percent to 40 percent annually through 1990, is increasingly turning to lower-end systems that have the necessary speed, graphics, and memory. Ideal for this environment, the Commodore Amiga 2000 can serve either as a personal workstation or as a terminal in a local area network, such as Ethernet.

A third-party developer recently introduced an industry standard Network File System (NFS) that incorporates standard Internet protocol (TCP/IP, UDP/IP) with remote login and that in the future can bring the UNIX world to the Commodore Amiga 2000. For advanced mathematics, Intel and Motorola co-processors are sim-

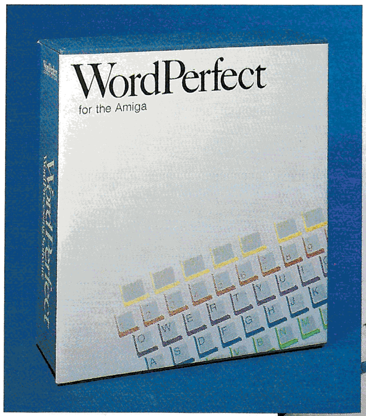
***The Commodore Amiga 500 and 2000 offer multi-tasking. The ability to perform more than one process at the same time is a significant advantage in business environments, since the user can work on one program while the computer works on another.***


Commodore computers enjoy strong positions in the business markets of Europe. The Company's strength in systems sales attracts the development of software like this popular database management program, whose multilingual versions are used on Commodore computers all across the continent and around the world.



The Amiga Bridgeboard provides MS-DOS PC compatibility and access to a vast catalog of information-processing programs currently used by business worldwide.

Among the more than 700 software titles currently available for the Commodore Amiga computers are many popular business programs, including this recent addition.




ply plugged in, and from the University of Lowell (Massachusetts), a pipe-line-style digital signal processing card can run up to 35-MIPS (million instructions per second) for high-speed, DMA-based graphics and animation image processing—as fast and, in some cases, faster than more expensive workstations.

Commodore intends to continue working both internally and with its developers to support and nurture new and improved specialty applications that take advantage of the many powerful and specialized abilities of the Commodore Amiga 2000. It is a perfect entry to open new market segments for the Commodore brand in the business sector.

Complementing this new product, the Commodore Amiga 500, the ultimate affordable home computer, was also introduced in fiscal 1987. Offering multi-tasking in the operating system, four-voice two-channel sound, built-in speech synthesis, 4,096-color graphics driven by proprietary custom graphics chips, and an easy-to-learn window-oriented user interface, the Commodore Amiga 500 meets and exceeds the most exacting demands in home productivity, and educational and entertainment applications for all members of the family. The Commodore Amiga 500 is designed to build upon the existing base of some 10 million Commodore computer users worldwide.



## ENHANCING ESTABLISHED TECHNOLOGIES

While this year's development effort focused on Amiga technology, the Company also enhanced its other product lines. During the fiscal year, the Commodore 64, the world's most popular home computer, was complemented with new peripherals that provide a total of 320K in RAM, enhancing its functionality in productivity applications, including desktop publishing. At the more powerful end of the product line, the Commodore 128D was introduced in the United States, following its success in Europe. A professionally oriented system, the Commodore 128D features a smaller footprint with a built-in disk drive, single built-in power supply, and detachable keyboard. In the United States the Commodore 128D achieved strong sales with mass merchandise chains, such as Sears and U.S. military exchanges.

In markets outside the United States, Commodore's PC-compatible line was also expanded in fiscal 1987 by the introduction of the PC40, a PC AT-compatible computer with a 40-megabyte hard disk for increased speed. Commodore's PC-compatible family is a leading brand in the business sectors of European markets. In West Germany, for example, it is second only to IBM and is rapidly increasing its presence in the continent's other important national markets.

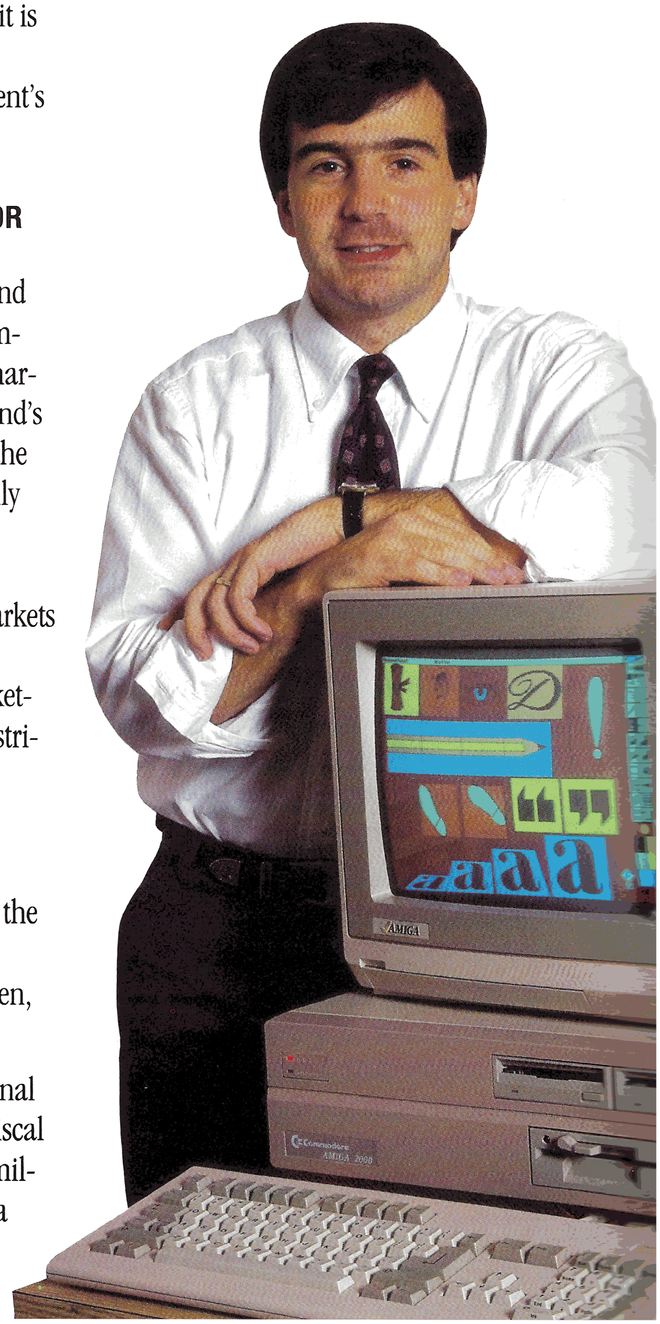
## INCREASING BUSINESS-SECTOR SALES

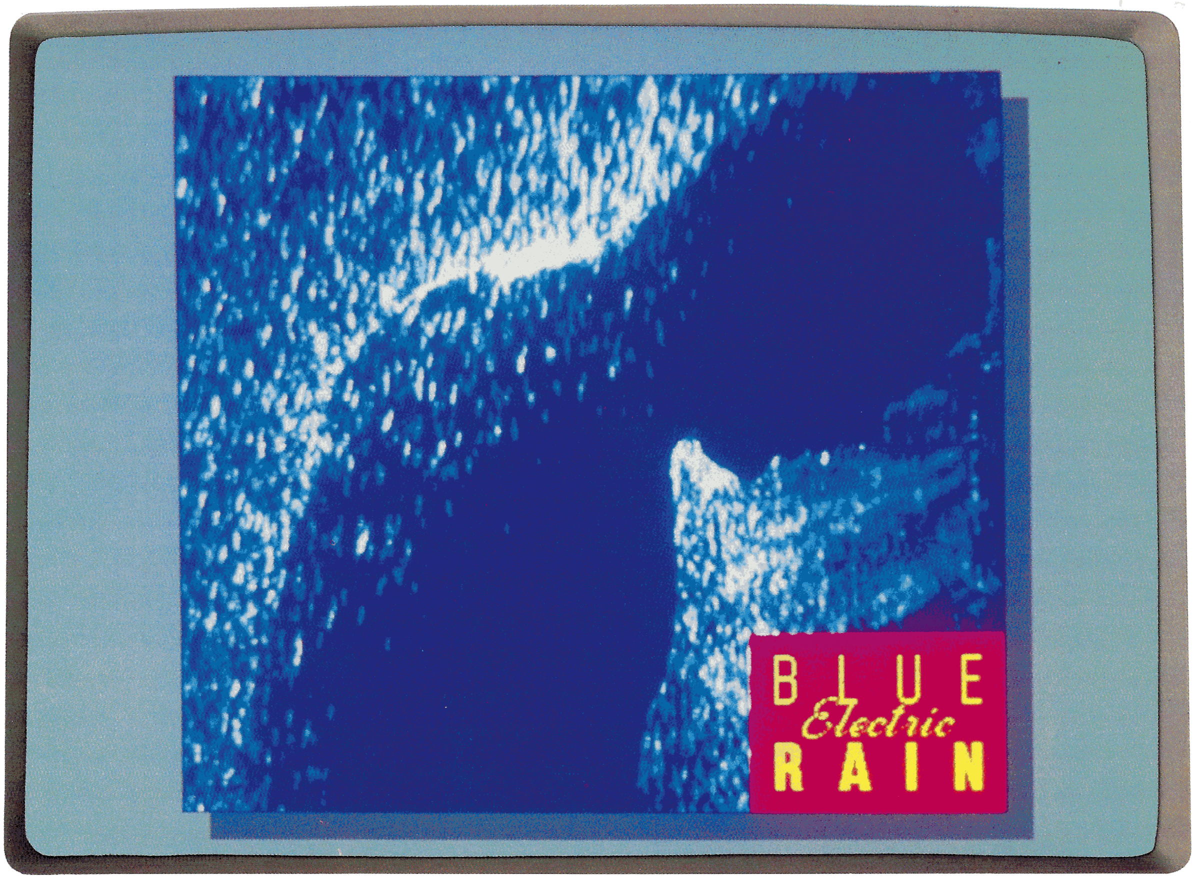
The expanded Commodore Amiga and PC-compatible lines allowed the Company to advance and accelerate its marketing strategy of enhancing the brand's position and increasing its share in the business systems sector, both generally and in specialized segments. During fiscal 1987 Commodore increased its business system sales in national markets outside the United States, while it strengthened both its sales and marketing operations and its methods of distribution in all its national markets to promote this trend worldwide.

In Western Europe, Commodore has attained a strong position in each of the national markets of West Germany, Switzerland, Belgium, Austria, Sweden, Denmark, and Norway.

One of Commodore's strongest national markets is West Germany, where in fiscal 1987 total sales revenues were $269 million. According to International Data

***The new term Desktop Presentation embraces the three graphics applications most important to business and professional communicators: desktop publishing, presentation graphics, and desktop video. The Commodore Amiga 2000 makes it possible to perform all three on the same personal computer.***






*Advertising art directors at Ted Bates Norway use Commodore Amiga technology throughout the entire pre-production phase. Colors, layouts, text, even images can be changed almost instantly. Art Director Bjorn Rybakken created this "rough" of a record cover in just 7 minutes.*



*High-impact slides for effective business presentations are executed easily and quickly using peripherals designed for the Commodore Amiga.*



*High-resolution digitized images from photography or video signals as well as four-color separations for magazine-quality publishing are among the Commodore Amiga's advanced applications in desktop presentation.*

Corporation, Commodore products commanded a 54 percent share of all microcomputer sales in this market in calendar 1986. In the same time period the Company placed number one in the consumer sector with a 75 percent share, while in the business sector, Commodore was second only to IBM with a 15 percent share of business systems sales.

Similarly positive results were achieved in other European national markets during fiscal 1987. In neighboring Austria, Commodore increased its consumer-sector share from 60 percent to 70 percent and its business-sector share from 7 percent to 10 percent. In Denmark and Norway, the Company maintained its consumer-sector shares at roughly 80 percent and 70 percent, respectively, and strengthened its business-sector share to roughly 8 percent in both markets.



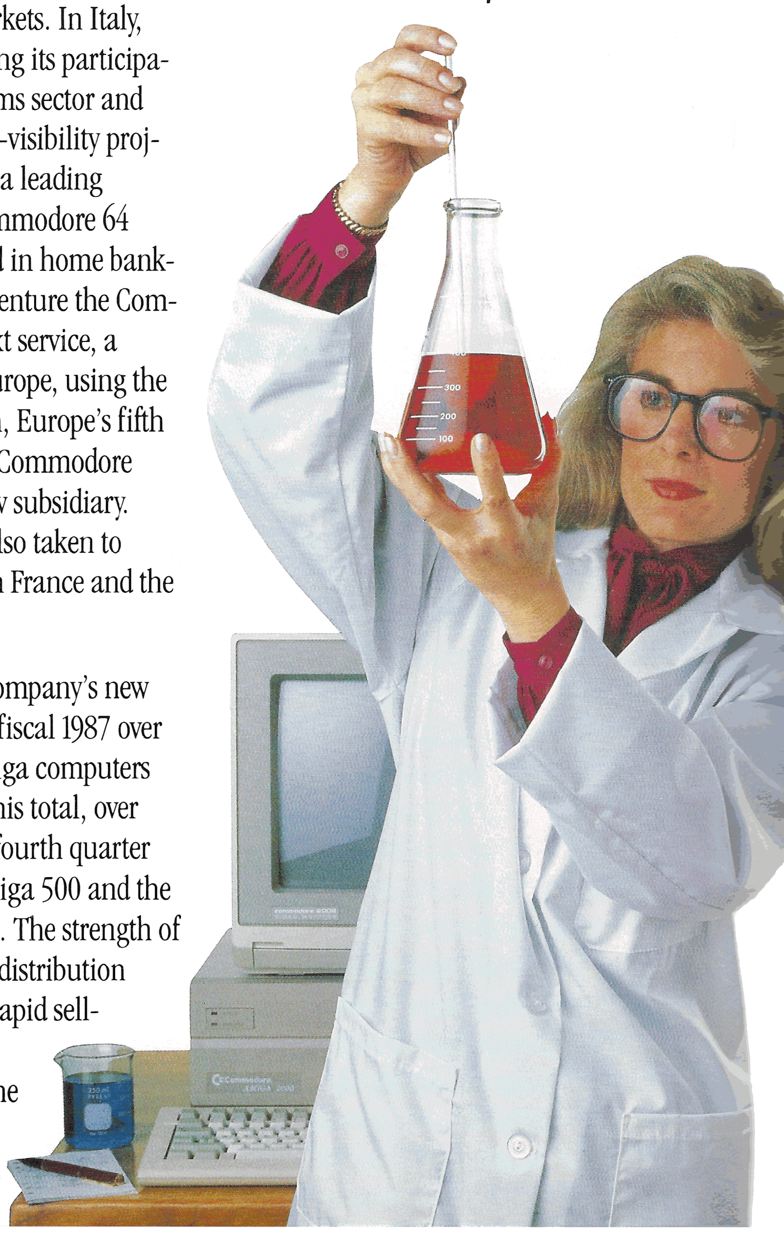
The successful implementation of the Company's marketing strategy is also clear in the increasing relative importance of business-sector sales in Commodore's product mix. In the Company's important European national markets, business-sector sales represented, on average, 27 percent of total sales in fiscal 1986. In fiscal 1987 business-sector sales in these national markets averaged 40 percent of total sales. In fiscal 1987 Switzerland became the first national market in which business-sector sales exceeded consumer-sector sales in the product mix.

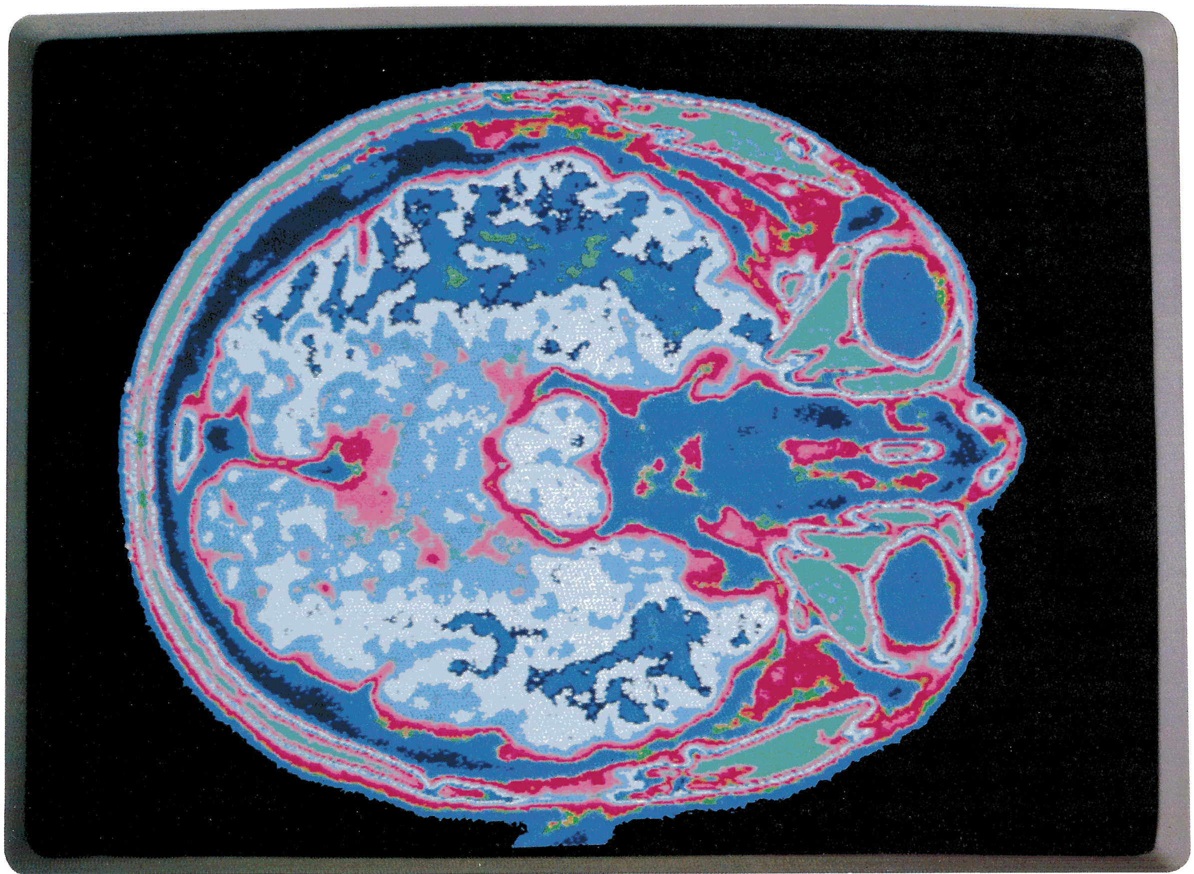
An increasing number of high-quality corporate accounts also confirms the success of the Company's new marketing direction. In West Germany Commodore has established corporate accounts with a long list of important worldwide companies, including BMW, Siemens, BASF, and Volkswagen and, during the fiscal year, added to its list Deutsche Bundesbahn (railroad), Thyssen (heavy industry), and Messerschmitt-Bölkow-Blohm GmbH (aerospace). Belgium landed Alfa-Laval, ITT, Colgate, Procter & Gamble, Goodyear, and Kellogg's in addition to important educational sales. In the United Kingdom, British Aerospace, British Gas, British Airways, Central Electricity Board, Westland Helicopters, and the RAF led a long list of new corporate accounts. In Austria, Commodore won a major national assurance association as well as institutional sales to the national government. Important new corporate accounts in Norway include Ted Bates (advertising), Kongsberg (armaments), and Norsk Hydro (utility). To support and advance its position, the Company expanded its internal sales staffs in Europe and in certain markets created separate sales divisions—one to service resellers, the other for corporate accounts.

Commodore also moved forward in other important European markets. In Italy, the Company is revitalizing its participation in the business systems sector and has undertaken two high-visibility projects. In cooperation with a leading financial institution, Commodore 64 computers are being used in home banking services. In another venture the Company launched a videotext service, a technology popular in Europe, using the Commodore 64. In Spain, Europe's fifth largest national market, Commodore recently established a new subsidiary. Significant efforts were also taken to strengthen distribution in France and the United Kingdom.

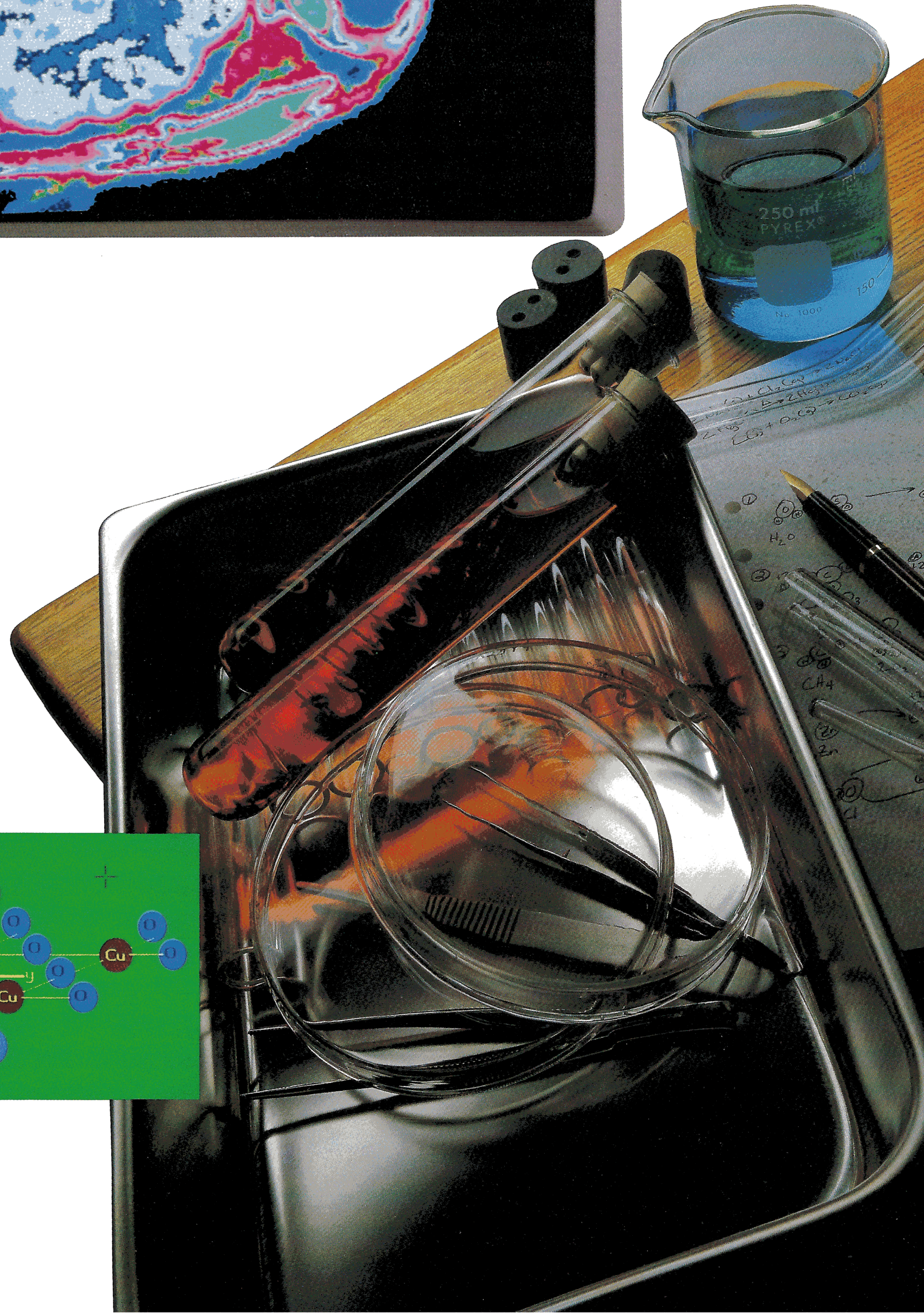
Market response to the Company's new products was positive. In fiscal 1987 over 100,000 Commodore Amiga computers were sold in Europe. Of this total, over half was achieved in the fourth quarter with the Commodore Amiga 500 and the Commodore Amiga 2000. The strength of Commodore's European distribution channels helped ensure rapid sell-through in both business and consumer sectors. The same factor played an

**_Open architecture, expandable to nine megabytes, and 4,096 colors make the Commodore Amiga 2000 a powerful and cost-effective personal workstation in scientific research and engineering applications. It can also be linked to a local area network and can run up to 35 million instructions per second._**



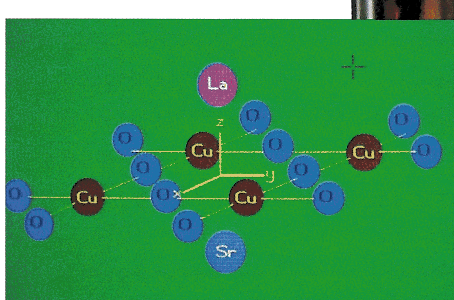


*At the UCLA Brain Research Institute, digital data from magnetic resonance imaging devices are fed into Commodore Amiga computers to assist in brain tissue research and stereotactic surgery. These computers are also used to create instructional videos at teaching hospitals.*




*Commodore Amiga technology helps guide the minute movements of Mt. Palomar, the Western world's largest observatory.*

*Physicists at MIT's Department of Materials Science plot and study the molecular changes in superconducting materials at different degrees Kelvin by using specially equipped Commodore Amiga computers.*



important role in the successful introduction of the PC40, which sold particularly well in West Germany and Switzerland.

## EXPANDING OLD AND NEW MARKETS

Anticipating the market introduction of the new Commodore Amiga products in the United States, the Company continued to build a U.S. distribution network of specialty computer resellers and selected consumer electronics outlets that can support the technically sophisticated and demonstration-sensitive Commodore Amiga computers. Commodore is also working with specialized dealers, on a test basis, who will focus on particular business-sector segments, such as film production companies, advertising agencies, small businesses, and marketing departments of major corporations, as well as on the university level of the U.S. education market. In addition, under development are comprehensive recruitment and support programs for value-added resellers who customize the product for specific end-user applications.



In the United States, efforts to introduce the Commodore Amiga 2000 to the business sector have included increased participation in vertical market trade shows, most notably in publishing and graphics. To support Commodore Amiga computers at the retail level, national sales promotion campaigns for the product line will be launched early in fiscal 1988. These integrated campaigns extend from national print and broadcast advertising to point-of-purchase materials. Included is an innovative take-home videocassette on the Commodore Amiga 500.

In the United States Commodore has also enhanced its independent developer program; become more active in working with original equipment manufacturers, including Bally, Expertel, and Beckman Instruments; and increased the number of service centers by 40 percent, from 750 in fiscal 1986 to 1,200 in fiscal 1987. Additionally, a dramatically expanded training program was launched in fiscal 1987 to help ensure that all locations offer certified servicers for all three product lines as well as on-site service in business environments for the Commodore Amiga 2000.

To strengthen the organization of its U.S. sales effort, Commodore opened four regional sales offices in fiscal 1987, increased its sales personnel while reducing administrative headcount, and dramatically changed its reliance on regional distributorship-based sales by retaining only key, strategically located U.S. distributors. This restructuring gives Commodore more direct access to its dealer base and greater involvement in product marketing by providing increased support to both dealers and end-users.

In Canada, the new Commodore Amiga computers were enthusiastically received by both resellers and end-users as was the PC AT-compatible PC40. The wider range of products and larger internal sales organization helped Commodore increase its independent dealer base in Canada by 20 percent during fiscal 1987 while reducing its reliance upon the mass merchandising business. Marking the Company's success in this market, the fourth annual "World of Commodore", the largest computer show in Canada, is expected to draw more than 40,000 attendees in 1987.

Commodore's Australian operation retained a strong 70 percent share of the home sector. As in other countries, the new Commodore Amiga and PC-compatible computers found ready market acceptance. With the new Commodore Amiga 2000 and the Commodore Amiga 500, the Company made rapid inroads into the corporate, small business, gov-

***Home computing today means education, games, music, and art for all members of the family as well as information processing for household and business purposes. Kids see Commodore Amiga technology on television every week in the special effects created by Lorimar art director Richard Lewis for the "Max Headroom" show.***


*Computers give children the freedom to be creative, not only in prose but in music and painting as well. Using a hand-held "mouse" allows children to enter commands merely by pointing and clicking a button. The software written for Commodore's 10 million users is among the world's best for children.*

*Playing games on personal computers is a popular pastime for young and old. Advanced graphics enables Commodore to offer home versions of arcade favorites.*


*More than 700 programs are already available for the Commodore Amiga computers; more than 6,000 for the long-lived Commodore 64 and 128 models.*

ernment, and technical/scientific segments of the business sector and now claims shares ranging from 4 percent in the government segment to 15 percent in the technical/scientific community. In Australia's educational market, four of the country's six state school systems officially accepted the Commodore Amiga 500 in all categories, displacing in some cases rival products.

In countries where Commodore does not have its own subsidiaries, the Company markets its products through independent distributors. Among those countries is Finland where, through PCI-Data, Commodore computers have a strong presence in all market segments. In the Mediterranean region, Commodore sales are increasing rapidly in Turkey, which could soon become a very strong national market.



In the Latin American region, Commodore has an established and growing presence in the national markets of both Mexico and Argentina and during fiscal 1987 increased its activities in the national markets of Colombia, Peru, and Bolivia.

In the Asia/Pacific region, new distributor arrangements, such as in India, resulted in a more aggressive selling posture. That effort and the credibility of Commodore's PC-compatible computers brought an immediate increase in sales revenues and indications of still untapped market demand.

## LOOKING AHEAD

The commitment and ability of Commodore International to provide a better technology at a better price in all the markets it serves around the world has been and will continue to be the source of the Company's success.

To the fulfillment of that mission in the coming fiscal year, Commodore International brings a stronger financial base and financial management combined with an unswerving commitment to continued progress in achieving cost efficiencies throughout its worldwide operations. To each of its important national markets, the Company brings enhanced sales and marketing programs as well as expanded methods of distribution. To all of its national markets, the Company brings an ongoing determination to develop new and exciting personal computers like the Commodore Amiga 2000 and the Commodore Amiga 500.

## CONTENTS



# FINANCIAL REVIEW

## SALES

Net sales were $806 million in 1987, $889 million in 1986 and $883 million in 1985. The Commodore 64 and the upgraded C128 plus related peripherals have accounted for a major portion of sales for each of the last three years. Unit sales of the C64 were almost 2 million in 1985. In fiscal 1986 an upgraded C128 was added to the product family and combined sales of the C64 and C128 were 1.9 million units in fiscal 1986 and 1.3 million units in fiscal 1987. In February 1985 prices for the C64 and related peripherals were reduced significantly and in May 1986 prices were increased with the launch of the redesigned C64. The higher priced C128 was introduced in August 1985. Including related peripherals the C64 and C128 products accounted for approximately 80% of fiscal 1986 sales and 70% of fiscal 1987 sales.

In April 1985 the IBM-compatible PC 10 and PC 20 were introduced in Europe and the PC 40 was added to the product group in fiscal 1987. Total PC unit volume was 76% higher in fiscal 1987 compared with fiscal 1986. In September 1985 the Amiga 1000 was launched and the Amiga 500 and Amiga 2000 were added to the product group in April 1987. Total Amiga unit volume was 100% higher in fiscal 1987 compared with fiscal 1986.



## FISCAL 1987 AND 1986

The Company's return to profitability occurred in the fourth quarter of fiscal 1986 and continued for each of the four quarters of 1987. The following schedule highlights the quarterly results:

| Net Income | Fiscal 1987 | Fiscal 1986 |
|---|---|---|
| | (millions) | |
| 1st Quarter | **$ 4** | ($39) |
| 2nd Quarter | **22** | (53) |
| 3rd Quarter | **1** | (37) |
| 4th Quarter | **2** | 1 |
| Year | **$29** | ($128) |

The strong profits in the second quarter of 1987 reflect the seasonal impact of Christmas.

Sales for fiscal 1987 were $806 million, or 9% below the prior year. Although the PC and Amiga revenues increased, there was a greater decline in revenues for the C64 and C128 group. The strengthening of European currencies versus the dollar had a favorable impact on sales. The dollar value of sales for 1987

would have been approximately $100 million lower if prior year exchange rates had been in effect.

Gross margin was $212 million or 26% in 1987 compared with $170 million or 19% in 1986. The increase was primarily due to the lack of significant inventory writedowns in 1987. Operating expenses, which included restructuring charges of $2 million in 1987 and $27 million in 1986, decreased from $273 million in 1986 to $165 million in 1987. Tight control was maintained for all expense categories in fiscal 1987. Advertising and merchandising expenses were reduced by slightly over 50% and other selling and distribution expenses were reduced by 25%. Total selling expenses decreased $66 million. General and administrative expenses increased $2.5 million while research and development expenditures decreased $20 million.

With the significant reduction in bank debt, interest expense decreased by $10 million to $18 million in fiscal 1987. In fiscal 1987 pretax income was $33 million compared with a pretax loss of $124 million in 1986. After utilization of net operating loss carryforwards of $6 million in fiscal 1987 the net income tax provision was $4 million, resulting in net income of $29 million, or $.89 per share compared with a net loss of $128 million in 1986.



## FISCAL 1986 AND 1985

Sales for fiscal 1986 were $889 million, slightly higher than the $883 million for 1985. Sales of the new PC and Amiga products offset a decline in the combined sales of the C64 and C128 group. The strengthening of European currencies versus the U.S. dollar had a favorable impact on sales in fiscal 1986. The dollar value of sales for 1986 would have been approximately $69 million lower if prior year exchange rates had been in effect.

Gross margin was $170 million in 1986 compared with $165 million in 1985. Two major factors contributed to this variance. There was a significant decrease in inventory writedowns from $63 million in 1985 to $34 million in 1986. This favorable impact was offset by an increase in the cost of products sourced in Japan due to the weakening of the U.S. dollar in fiscal 1986.

Operating expenses for 1986 were $273 million compared with $250 million in 1985. Advertising and merchandising expenses decreased significantly in the Christmas quarter, but were offset by increases in other selling expenses. Total selling expenses decreased by $4 million. General and administrative expenses increased $6 million, primarily due to heavy professional fees related to negotiations with the worldwide bank group and other administrative matters. The acquisition of the Amiga technology resulted in $8 million of amortization, which was offset by reduced expenditures for research and development of $10 million. In fiscal 1986 the decision was made to close the semiconductor facility in California and the computer assembly facility in the United Kingdom. All sales and marketing organizations were also streamlined and total worldwide employment was reduced by 1400 employees. In fiscal 1986 restructuring costs were $27 million primarily for the writeoff of excess equipment. In 1985 restructuring costs were $3 million for the loss on the sale of the Canadian Steel Division and a writedown of certain idle semiconductor equipment.

Reduced inventories allowed bank debt to be reduced in mid-1986 and, combined with a reduction in interest rates, interest expense decreased $4.5 million to $28 million in 1986. Realized currency transaction gains/losses accounted for most of the other income of $7 million in 1986 and other expense of $7 million in 1985.

The pretax loss was $124 million in 1986 and $125 million in 1985. In 1986 there was an income tax provision of $4 million because operations in certain European countries were profitable and losses in the U.S. and other countries could not be carried back to prior years. In 1985 there was an income tax benefit of $11 million due to carryback of losses in certain countries. The net loss was $128 million in 1986 compared with $114 million in 1985.

## LIQUIDITY AND CAPITAL RESOURCES

As a result of the return to profitability in fiscal 1987, the Company's financial strength was significantly improved. With the net income of $29 million and depreciation and amortization of $30 million total working capital provided from operations was $59 million in 1987 compared with a use of working capital in the prior two years.

Long-term debt continued to decrease with a reduction of $65 million in fiscal 1987. In May 1987, the Company obtained additional long-term financing by issuing $20 million of senior notes and $40 million of subordinated notes to the Prudential Insurance Company of America. Capital expenditures in 1987 were $9.5 million, primarily for upgrading of production equipment and facilities.

Total working capital increased from $132 million at 30 June 1986 to $196 million at 30 June 1987. Total shareholders' equity increased by $40 million to $145 million at 30 June 1987. With continued profitability and emphasis on working capital management the Company anticipates that there will be sufficient cash flow to finance operations and to meet current obligations.

## FIVE-YEAR COMPARISON OF SELECTED FINANCIAL DATA

Commodore International Limited and Subsidiaries
(000's omitted, except per share amounts)

| Year Ended 30 June | **1987** | 1986 | 1985 | 1984 | 1983 |
|---|---|---|---|---|---|
| **Net sales** | **$806,700** | $889,300 | $883,100 | $1,267,200 | $681,200 |
| Gross profit | **212,400** | 170,500 | 165,100 | 466,800 | 320,800 |
| Operating expenses (1) | **164,800** | 273,100 | 249,800 | 219,900 | 201,400 |
| Interest expense, net | **18,100** | 28,100 | 32,600 | 20,400 | 8,000 |
| Other expense (income), net | **(2,900)** | (7,000) | 7,300 | 2,000 | (1,500) |
| | **180,000** | 294,200 | 289,700 | 242,300 | 207,900 |
| Income (loss) before income taxes and extraordinary item | **32,400** | (123,700) | (124,600) | 224,500 | 112,900 |
| Income tax provision (benefit) | **9,800** | 4,200 | (10,700) | 80,700 | 24,900 |
| Income (loss) before extraordinary item | **22,600** | (127,900) | (113,900) | 143,800 | 88,000 |
| Extraordinary item (2) | **6,000** | — | — | — | 3,700 |
| **Net income (loss)** | **$28,600** | ($127,900) | ($113,900) | $143,800 | $91,700 |
| Per share data: | | | | | |
| Income (loss) before extraordinary item | **$0.71** | ($4.08) | ($3.66) | $4.66 | $2.86 |
| Extraordinary item (2) | **0.18** | — | — | — | 0.12 |
| **Net income (loss)** | **$0.89** | ($4.08) | ($3.66) | $4.66 | $2.98 |
| Weighted average shares | **32,144** | 31,278 | 31,142 | 30,859 | 30,809 |
| Financial Position—30 June | | | | | |
| Current assets | **$416,600** | $375,100 | $509,200 | $574,400 | $532,700 |
| Current liabilities (3) | **220,300** | 243,400 | 413,500 | 269,900 | 327,900 |
| Working capital (3) | **196,300** | 131,700 | 95,700 | 304,500 | 204,800 |
| Total assets | **517,500** | 504,900 | 680,800 | 679,000 | 614,600 |
| Long-term debt (3) | **149,600** | 154,500 | 34,100 | 77,300 | 92,000 |
| Shareholders' equity | **145,000** | 105,000 | 222,500 | 324,400 | 190,700 |

(1) Includes restructuring charges.
(2) Tax benefit of net operating loss carryforward.
(3) See note 1 to the consolidated financial statements regarding current developments.

## CONSOLIDATED STATEMENTS OF OPERATIONS

Commodore International Limited and Subsidiaries
(000's omitted, except per share amounts)

| Year Ended 30 June | 1987 | 1986 | 1985 |
|---|---|---|---|
| **Net sales** (Note 2) | **$806,700** | $ 889,300 | $ 883,100 |
| Cost of sales | **594,300** | 718,800 | 718,000 |
| Gross profit | **212,400** | 170,500 | 165,100 |
| Operating expenses: | | | |
| Selling, including advertising | **95,300** | 160,900 | 165,300 |
| General and administrative | **42,900** | 40,400 | 34,300 |
| Research and development (Note 2) | **16,400** | 36,800 | 46,500 |
| Amortization of acquired technology (Note 2) | **7,900** | 8,000 | — |
| Restructuring charges (Note 2) | **2,300** | 27,000 | 3,700 |
| Total operating expenses | **164,800** | 273,100 | 249,800 |
| Income (loss) from operations | **47,600** | (102,600) | (84,700) |
| Interest expense, net of interest income of $2,100, $2,200 and $2,100, respectively | **18,100** | 28,100 | 32,600 |
| Other expense (income) (Note 2) | **(2,900)** | (7,000) | 7,300 |
| Income (loss) before income taxes and extraordinary item | **32,400** | (123,700) | (124,600) |
| Income tax provision (benefit) (Note 3) | **9,800** | 4,200 | (10,700) |
| Income (loss) before extraordinary item | **22,600** | (127,900) | (113,900) |
| Extraordinary item (Note 3) | **6,000** | — | — |
| **Net income (loss)** | **$ 28,600** | $(127,900) | $(113,900) |
| **Per share data** (Note 2): | | | |
| Income (loss) before extraordinary item | **$ 0.71** | $ (4.08) | $ (3.66) |
| Extraordinary item | **0.18** | — | — |
| Net income (loss) | **$ 0.89** | $ (4.08) | $ (3.66) |

The accompanying notes are an integral part of these statements.

## CONSOLIDATED BALANCE SHEETS

Commodore International Limited and Subsidiaries
(000's omitted)

| **Assets** | **30 June 1987** | 30 June 1986 |
|---|---|---|
| **Current Assets:** | | |
| Cash and equivalents | **$ 49,000** | $ 31,800 |
| Accounts receivable, net of allowances for doubtful accounts of $31,600 and $17,700, respectively | **167,000** | 129,000 |
| Inventories (Note 2) | **193,300** | 202,300 |
| Other current assets | **7,300** | 12,000 |
| Total current assets | **416,600** | 375,100 |
| **Property and equipment,** at cost (Note 2) | **143,600** | 157,500 |
| Accumulated depreciation and amortization | **(67,400)** | (64,100) |
| Net property and equipment | **76,200** | 93,400 |
| **Acquired technology** (Note 2) | **15,800** | 23,700 |
| **Other assets** (Note 2) | **8,900** | 12,700 |
| | **$517,500** | $504,900 |
| **Liabilities and Shareholders' Equity** | | |
| **Current Liabilities:** | | |
| Bank debt (Notes 1 and 4) | **$ 19,500** | $ 27,200 |
| Current portion of long-term debt | **43,600** | 40,300 |
| Accounts payable | **75,700** | 78,700 |
| Accrued liabilities | **35,600** | 40,700 |
| Taxes payable (Notes 2 and 3) | **45,900** | 56,500 |
| Total current liabilities | **220,300** | 243,400 |
| **Long-term debt** (Notes 1 and 5) | **149,600** | 154,500 |
| **Deferred income taxes** (Note 3) | **2,600** | 2,000 |
| **Commitments and contingencies** (Note 9) | **—** | — |
| **Shareholders' Equity** (Notes 2 and 6) | | |
| Capital stock, $.01 stated value | | |
| Authorized 90,000,000 shares | | |
| Issued 32,310,508 and 31,934,879 shares, respectively | **300** | 300 |
| Contributed surplus | **32,300** | 32,300 |
| Retained earnings | **117,500** | 88,900 |
| Cumulative translation adjustment | **(2,500)** | (12,400) |
| Unearned compensation | **(2,100)** | (3,600) |
| Treasury stock—650,553 and 186,182 shares, respectively, at cost | **(500)** | (500) |
| Total shareholders' equity | **145,000** | 105,000 |
| | **$517,500** | $504,900 |

The accompanying notes are an integral part of these statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Commodore International Limited and Subsidiaries
(000's omitted)

| | Capital Stock | Contributed Surplus | Retained Earnings | Cumulative Translation Adjustment | Unearned Compensation | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|
| **Balance, 30 June 1984** | $300 | $14,400 | $330,700 | ($20,800) | $ — | ($200) | $324,400 |
| Net (loss) | — | — | (113,900) | — | — | — | (113,900) |
| Foreign currency translation adjustments for year | — | — | — | (1,900) | — | — | (1,900) |
| Issuance of shares for acquisition of Amiga Computer, Inc. (Note 2) | — | 13,700 | — | — | — | — | 13,700 |
| Sale of stock to an officer | — | 400 | — | — | — | — | 400 |
| Exercise of employee stock options | — | 100 | — | — | — | — | 100 |
| Purchase of treasury stock | — | — | — | — | — | (300) | (300) |
| **Balance, 30 June 1985** | 300 | 28,600 | 216,800 | (22,700) | — | (500) | 222,500 |
| Net (loss) | — | — | (127,900) | — | | | (127,900) |
| Foreign currency translation adjustments for year | — | — | — | 10,300 | | | 10,300 |
| Issuance of shares to an officer pursuant to employment contract (Note 6) | — | 3,600 | — | — | (3,600) | | — |
| Exercise of employee stock options | — | 100 | — | — | | | 100 |
| **Balance, 30 June 1986** | 300 | 32,300 | 88,900 | (12,400) | (3,600) | (500) | 105,000 |
| Net income | — | — | 28,600 | — | — | — | 28,600 |
| Foreign currency translation adjustments for year | — | — | — | 9,900 | — | — | 9,900 |
| Issuance of shares for acquisition of Amiga Computer, Inc. (Note 2) | — | 800 | — | — | — | — | 800 |
| Issuance of shares to an officer pursuant to employment contract (Note 6) | — | 2,400 | — | — | (2,400) | — | — |
| Cancellation of shares issued to an officer (Note 6) | — | (3,600) | — | — | 3,600 | — | — |
| Amortization of unearned compensation | — | — | — | — | 300 | — | 300 |
| Exercise of employee stock options | — | 400 | — | — | — | — | 400 |
| **Balance, 30 June 1987** | $300 | $32,300 | $117,500 | ($2,500) | ($2,100) | ($500) | $145,000 |

The accompanying notes are an integral part of these statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Commodore International Limited and Subsidiaries
(000's omitted)

| Year Ended 30 June | **1987** | 1986 | 1985 |
|---|---|---|---|
| **Working Capital was Provided by (Used in):** | | | |
| Net income (loss) | **$28,600** | $(127,900) | $(113,900) |
| Items not requiring working capital— | | | |
| Depreciation and amortization | **30,200** | 39,100 | 31,100 |
| Deferred income taxes and other | **700** | (4,300) | (2,500) |
| Total working capital provided by (used in) operations | **59,500** | (93,100) | (85,300) |
| Proceeds of long-term notes and debentures | **60,000** | — | 33,000 |
| Reclassification of long-term debt and debentures | **—** | 130,600 | (177,700) |
| Increase in long-term debt | **—** | — | 120,900 |
| Net book value of property and equipment retired | **6,900** | 25,100 | 6,400 |
| Consolidation of finance subsidiary (Note 2) | **3,000** | — | — |
| Fair value of common stock issued for acquisition of Amiga Computer, Inc. | **800** | — | 13,700 |
| Proceeds from issuance of stock | **400** | 100 | 500 |
| Total working capital provided (used) | **130,600** | 62,700 | (88,500) |
| **Working Capital was Applied to:** | | | |
| Purchase of property and equipment | **9,500** | 19,100 | 63,800 |
| Acquisition of Amiga Computer, Inc.: | | | |
| Acquired technology | **—** | — | 31,700 |
| Property and equipment | **—** | — | 700 |
| Other long-term liabilities | **—** | — | (5,000) |
| Decrease in long-term debt | **64,900** | 10,200 | 19,400 |
| Effect of exchange rate changes on working capital | **(7,400)** | (3,900) | 1,400 |
| Other, net | **(1,000)** | 1,300 | 8,300 |
| Total working capital applied | **66,000** | 26,700 | 120,300 |
| Increase (decrease) in working capital | **$64,600** | $36,000 | $(208,800) |
| **Analysis of Increase (Decrease) in Working Capital:** | | | |
| Increase (decrease) in current assets— | | | |
| Cash and equivalents | **$17,200** | $ 23,400 | ($14,700) |
| Accounts receivable | **38,000** | (13,600) | (95,200) |
| Inventories | **(9,000)** | (112,400) | 6,400 |
| Other current assets | **(4,700)** | (31,500) | 38,300 |
| | **41,500** | (134,100) | (65,200) |
| (Increase) decrease in current liabilities— | | | |
| Bank debt | **7,700** | 165,300 | (188,300) |
| Current portion of long-term debt | **(3,300)** | 8,300 | (40,800) |
| Accounts payable and accrued liabilities | **8,100** | (5,900) | 80,200 |
| Taxes payable | **10,600** | 2,400 | 5,300 |
| | **23,100** | 170,100 | (143,600) |
| Net increase (decrease) in working capital | **64,600** | 36,000 | (208,800) |
| Working capital, beginning of year | **131,700** | 95,700 | 304,500 |
| Working capital, end of year | **$196,300** | $131,700 | $95,700 |

The accompanying notes are an integral part of these statements.

## 1 CURRENT DEVELOPMENTS

During the two fiscal years ended 30 June 1985 and 1986, the Company incurred net losses of over $100 million in each year. A large portion of the losses in both years were non-cash since they were write-downs of inventories and excess property and equipment to net realizable value. In the year ended 30 June 1987, the Company achieved net income of $28.6 million on sales of $806.7 million, principally from existing products. Management has forecast continued successful operations, however, there can be no assurance that such success will be achieved. The Company is in a very competitive industry which includes competitors that are larger and may have greater financial resources.

The Company's short-term and long-term financing increased by $185.9 million during fiscal 1985 and total bank debt was reduced by $59.1 million in fiscal 1986. During the year ended 30 June 1987, the Company obtained $60 million of long-term financing, as discussed in Note 5, and reduced bank debt by $68 million. In September 1987, an agreement in principle was reached for a new credit facility with the Company's major bank group, extending until 30 September 1988, which requires maintenance of certain financial ratios and minimum levels of net worth for each quarterly period during the term of the agreement.



## 2 SUMMARY OF ACCOUNTING POLICIES

Commodore International Limited is incorporated in the Bahamas. The consolidated financial statements of Commodore International Limited and Subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States. Within those principles, the Company's more important accounting policies are set forth below.

### Principles of Consolidation

The consolidated financial statements include the accounts of all majority-owned subsidiaries. All significant intercompany accounts, transactions and profits have been eliminated.

As of 30 June 1987, the Company's wholly-owned finance subsidiary was included in the consolidated financial statements. In prior years the finance subsidiary was accounted for using the equity method. Condensed financial information for the finance subsidiary as of 30 June 1986 was as follows (000s omitted):

| | |
|---|---|
| Assets: | |
| Cash | $ 100 |
| Accounts receivable | 8,800 |
| | $8,900 |
| Liabilities and Shareholders' Equity: | |
| Bank debt | $5,400 |
| Other liabilities | 500 |
| Shareholders' equity | 3,000 |
| | $8,900 |

### Translation of Non-U.S. Currencies

Assets and liabilities recorded in functional currencies other than U.S. dollars are translated at current exchange rates. The resulting adjustments are charged or credited directly to cumulative translation adjustment in the shareholders' equity section of the consolidated balance sheets. Sales and expenses are translated at the weighted average exchange rates for the period. All foreign currency transaction gains and losses are included in income in the period in which they occur. Realized currency gains (losses) of $6.7 million, $5.7 million and $(9.5) million for fiscal 1987, 1986 and 1985, respectively, were included in the consolidated statements of operations as other income (expense).

### Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market, and are inclusive of material, labor and overhead. Intercompany profits are eliminated from inventory valuations. Inventories, net of reserves, consisted of the following (000s omitted);

| | 30 June | |
|---|---|---|
| | **1987** | 1986 |
| Raw materials and work-in-process | **$ 85,000** | $ 85,900 |
| Finished goods | **108,300** | 116,400 |
| | **$193,300** | $202,300 |

## Property and Equipment

Major classes of property and equipment were as follows (000s omitted):

| Description | 30 June 1987 | 1986 | Estimated Useful Lives |
|---|---|---|---|
| Land | **$ 3,100** | $ 2,900 | |
| Buildings and improvements | **33,000** | 36,700 | 10–40 years |
| Machinery and equipment | **79,000** | 85,800 | 3–10 years |
| Furniture and fixtures | **10,900** | 9,600 | 3–10 years |
| Tooling | **6,500** | 11,900 | 2–5 years |
| Leasehold improvements | **11,100** | 10,600 | Lease Term |
| | **$143,600** | $157,500 | |

Net book value of property and equipment of U.S. semiconductor operations at 30 June 1987 was $31.4 million.

Depreciation has been provided over the estimated useful lives of the assets using primarily the straight-line method. Expenditures for additions, renewals and betterments are capitalized. Maintenance and repairs are expensed as incurred. Upon sale or other disposition, the applicable amounts of asset cost and accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to income.

## Income Taxes

The Company and its subsidiaries provide taxes on income in accordance with the tax rules and regulations of the many taxing jurisdictions where the income is earned. The income tax rates imposed by these taxing jurisdictions vary substantially. Taxable income may differ from pretax income for financial accounting purposes. To the extent that differences are due to expense items reported in one period for tax purposes and in another period for financial reporting purposes, appropriate provision for deferred income taxes is made. The Company does not provide income taxes on undistributed earnings of foreign subsidiaries which are permanently reinvested.

Investment credits and other allowances provided by income tax laws of respective countries are credited to current income tax expense under the flow-through method of accounting.

## Revenue Recognition

Sales are recognized when products are shipped, net of allowances for estimated returns and discounts.

## Restructuring Charges

Restructuring charges relate principally to facility rationalizations and include severance and other shutdown expenses.

## Barter Arrangements

During fiscal 1985 and 1984, the Company entered into agreements which provided for products to be exchanged for advertising and other services. The Company accounts for the income from such barter arrangements based upon the fair value of the products exchanged for the barter credits.

## Research and Development Costs

The Company expenses all research and development costs, including software development costs, as incurred.

## Acquired Technology

In October 1984, the Company acquired Amiga Computer, Inc. for capital stock and cash. In fiscal 1985, 521,578 shares were issued and in fiscal 1987, 28,367 shares were issued. The acquisition was accounted for as a purchase and the excess ($31.7 million) of the purchase price over the fair value of net tangible assets acquired has been classified as acquired technology in the consolidated balance sheet, and is being amortized on a straight-line basis over a four-year period commencing in fiscal 1986.

## Reclassifications

Certain reclassifications have been made to conform with the 1987 presentation.

## Per Share Data

Per share data are calculated using the weighted average number of shares of capital stock and dilutive capital stock equivalents (stock options) outstanding during each year. The weighted average number of shares used to compute earnings per share was 32,144,000, 31,278,000 and 31,142,000 in 1987, 1986 and 1985, respectively.

## 3 INCOME TAXES

The income tax provision (benefit) consisted of the following (000s omitted):

| | **1987** | 1986 | 1985 |
|---|---|---|---|
| Current: | | | |
| U.S. Federal | **$ —** | $ — | $ (25,300) |
| Non-U.S. | **9,200** | 7,900 | 16,300 |
| Subtotal | **9,200** | 7,900 | (9,000) |
| Deferred: | | | |
| U.S. Federal | **—** | — | (3,000) |
| Non-U.S. | **600** | (3,700) | 1,300 |
| Subtotal | **600** | (3,700) | (1,700) |
| Total | **$9,800** | $4,200 | $ (10,700) |

Non-U.S. earnings (loss) before income taxes amounted to $56 million, ($30) million and ($54) million in 1987, 1986 and 1985, respectively. Deferred taxes related primarily to differences between tax depreciation and depreciation for financial reporting purposes.



The Company and its subsidiaries are engaged in business in countries with statutory tax rates ranging from zero to approximately 57%. Although there was a loss in the U.S. in 1987, the effective tax rate was 30% due to profitable operations in certain European countries. Despite the consolidated loss in 1986 there was an income tax provision because operations in certain European countries were profitable and losses in the U.S. and other countries could not be carried back to prior years. The tax benefit was only 9% in 1985 because certain subsidiaries had losses in excess of amounts that could be carried back to prior years.

As of 30 June 1987, the Company's U.S. subsidiaries have net operating loss carryforwards of approximately $94 million and investment and research tax credit carryforwards of $14 million which expire in years through 2002. Certain of the Company's non-U.S. subsidiaries have net operating loss carryforwards of approximately $79 million which expire at various dates through 1997.

The Company's U.S. subsidiaries are being audited by the Internal Revenue Service ("IRS") for fiscal years through 1985 and it is likely that deficiencies could be proposed for those years. As of 30 June 1987, management believes that the outcome of the U.S. audit will not materially affect the cash flow or consolidated financial position of the Company.

Certain of the Company's non-U.S. subsidiaries are undergoing routine audits by their local tax authorities. In Japan the tax authority has issued a deficiency notice for years 1982, 1983 and 1984. Management believes that the outcome of such audits will not materially affect the consolidated financial position of the Company.

Utilization of prior years' loss carryforwards has been treated as an extraordinary item in the consolidated statements of operations.

## 4 BANK DEBT

The Company and its subsidiaries had short-term bank borrowings of $19.5 million at 30 June 1987, at an average interest rate of 13.9% (1986—13.0%; 1985—10.6%). The maximum month-end short-term borrowings during fiscal 1987 were $27 million (1986—$74 million; 1985—$86 million). The average month-end short-term borrowings outstanding during fiscal 1987 were $22 million (1986—$37 million; 1985—$49 million) at a weighted average interest rate of 13.7% (1986—16.2%; 1985—11.4%).

As of 30 June 1987, the Company had unused short-term lines of credit of $27 million available in various currencies which permit borrowings at floating rates which vary from country to country depending upon local conditions. In certain countries under various informal and unrestricted arrangements, the Company maintains compensating balances to support credit facilities and services.

## 5 LONG-TERM DEBT

| | 30 June | |
|---|---|---|
| (000s omitted) | **1987** | 1986 |
| Debt with banks in United States, United Kingdom and West Germany | **$ 50,900** | $111,200 |
| Senior notes, 11.0% due March 1990–March 1993 | **20,000** | — |
| Subordinated notes, 12.0% due March 1990–March 1994 | **40,000** | — |
| Deutsche mark debentures, 7.5% due January 1992 | **54,900** | 45,400 |
| Real estate mortgages, 5.25% to 8.5% (1986—6.3% to 7.5%), due in varying amounts through 2000 | **6,500** | 8,600 |
| Capitalized lease obligations averaging 12.6% (1986—12.2%) payable in varying amounts through 2019 | **20,600** | 29,300 |
| Other | **300** | 300 |
| | **193,200** | 194,800 |
| Current Portion | **(43,600)** | (40,300) |
| | **$149,600** | $154,500 |

In September 1987, the Company reached an agreement in principle for a new credit agreement with a group of banks. Management contemplates that the formal agreement will be signed in October 1987. The agreement requires the Company and certain subsidiaries to maintain certain revised financial ratios and minimum level of net worth. The agreement requires minimum repayments of $37 million in fiscal 1988. The Company is not permitted to pay any dividends or acquire more than $2 million of its outstanding capital stock. The interest rate fluctuates based upon the banks' cost of funds. At 30 June 1987, the weighted average interest rate of the borrowings was 8.4%. Average month-end borrowings under the credit agreement were $93 million in 1987 and $123 million in 1986, at a weighted average interest rate of 8.9% and 10.3%, respectively. The maximum month-end borrowings were $117 million in 1987 and $150 million in 1986.

In May 1987, the Company issued $20 million of senior notes and $40 million of subordinated notes with warrants for 2,250,000 shares of capital stock to the Prudential Insurance Company of America. The warrants are exercisable at $11.40 per share until March 1994. Under the terms of the note agreement the Company is not permitted to pay dividends until 1989 and must maintain a certain minimum level of net worth.

Approximate annual maturities of long-term debt as of 30 June 1987 are as follows (000s omitted):

| | |
|---|---|
| 1988 | $ 43,600 |
| 1989 | 19,800 |
| 1990 | 15,400 |
| 1991 | 13,800 |
| 1992 | 68,700 |
| Later Years | 31,900 |
| | $193,200 |

## 6 CAPITAL STOCK

During fiscal 1985 the shareholders approved an increase in the authorized number of shares of capital stock to 90,000,000. As of 30 June 1987, the following shares of capital stock were reserved for future issuance:

| | |
|---|---|
| Stock Incentive Plan | 1,959,286 |
| Warrants | 2,250,000 |
| | 4,209,286 |

The Stock Incentive Plan for Key Employees provides for certain key employees to receive grants or options to purchase up to 3,000,000 shares of the Company's capital stock. Although the Plan allows for non-qualified stock options to be granted at a price below the market value, all options have been granted at the fair market value at the date of grant except for options for 300,000 shares granted to one officer at a price of $7.25, which was below the fair market value at the date of the grant. Options granted under the Plan expire ten years from the date of grant and outstanding options are exercisable in annual increments of 33⅓% beginning one year from the date of grant. As of 30 June 1987, options were held by 84 employees and range in exercise price from $6.38 to $13.25. These options expire on various dates from April 1995 to June 1997. There were 64,332 shares exercisable as of 30 June 1987. Option activity during 1986 and 1987 was as follows:

| | Number of Shares | Average Price Per Share | Total |
|---|---|---|---|
| Outstanding as of 30 June 1985 | 976,666 | $18.61 | $18,177,000 |
| Granted | 574,426 | 8.11 | 4,658,000 |
| Exercised | (9,000) | 5.79 | (52,000) |
| Cancelled | (659,092) | 17.30 | (11,400,000) |
| Outstanding as of 30 June 1986 | 883,000 | $12.89 | $11,383,000 |
| Granted | 908,500 | 8.23 | 7,478,000 |
| Exercised | (47,262) | 8.08 | (382,000) |
| Cancelled | (739,735) | 13.79 | (10,198,000) |
| Outstanding as of 30 June 1987 | 1,004,503 | $ 8.24 | $ 8,281,000 |

In fiscal 1987, a grant of 300,000 shares of capital stock was made to an officer at a price of $3,000 or $.01 per share. The shares vest at the rate of 20% per year beginning in August 1987. If the officer leaves the Company due to a merger or other change of control, all then-restricted shares vest immediately. The difference between the grant price and the fair market value at the date of grant has been charged to unearned compensation in the consolidated balance sheet and is being amortized over the vesting period.



In fiscal 1986, a grant of 500,000 shares of capital stock was made to an officer at a price of $5,000, or $.01 per share, vesting at the rate of 20% per year. In fiscal 1987, before any of the shares vested, the officer resigned, the grant was cancelled and the shares were recorded as treasury stock.

In fiscal 1985, 15,000 shares of capital stock were sold to an officer at the prevailing market price. The officer was also granted an option to purchase 300,000 shares of capital stock at an exercise price of $23.50, which was the prevailing market price at the date of grant. This option was cancelled in 1986 when the officer resigned.

When options are exercised the proceeds, including any applicable income tax benefit, are credited to capital stock and contributed surplus.

## 7 LEASES

The Company leases certain machinery and equipment, manufacturing facilities, warehouses and administrative offices with terms expiring at various dates to 2019. Typically, the Company pays property taxes, insurance and maintenance expenses related to the leased property. The gross value of property included under capital leases as of 30 June 1987 and 1986 was $27.8 million and $33.0 million, respectively. The related accumulated amortization as of 30 June 1987 and 1986 was $8.2 million and $16.3 million, respectively. Amortization expense of property under capital leases was $3.4 million in 1987, $6.1 million in 1986 and $11.1 million in 1985. Total rental expense under operating leases was $4.2 million in 1987, $3.4 million in 1986 and $2.4 million in 1985.

Minimum future obligations on leases as of 30 June 1987 are as follows (000s omitted):

| | Capital Leases | Operating Leases |
|---|---|---|
| 1988 | $ 9,000 | $ 4,000 |
| 1989 | 5,500 | 3,000 |
| 1990 | 3,200 | 2,100 |
| 1991 | 1,300 | 1,200 |
| 1992 | 1,300 | 700 |
| Later Years | 35,700 | 2,800 |
| Total minimum obligations | 56,000 | $13,800 |
| Amounts representing interest | 35,400 | |
| Present value of net minimum obligations | $20,600 | |

## 8 GEOGRAPHIC SEGMENT INFORMATION

| (000s omitted) | North America | Europe | Asia/ Australia | Eliminations | Consolidated |
|---|---|---|---|---|---|
| **1987** | | | | | |
| Sales to unaffiliated customers | **$255,900** | **$512,100** | **$ 38,700** | **$ —** | **$806,700** |
| Intersegment sales | **66,400** | **424,300** | **537,300** | **(1,028,000)** | **—** |
| Net sales | **322,300** | **936,400** | **576,000** | **(1,028,000)** | **806,700** |
| Income (loss) from operations | **(17,400)** | **62,700** | **(1,200)** | **3,500** | **47,600** |
| Interest expense, net | | | | | **(18,100)** |
| Other income | | | | | **2,900** |
| Income before income taxes | | | | | **32,400** |
| Identifiable assets | **210,000** | **256,800** | **74,800** | **(24,100)** | **517,500** |
| Depreciation expense | **11,200** | **5,900** | **5,200** | **—** | **22,300** |
| Capital expenditures | **3,400** | **3,700** | **2,400** | **—** | **9,500** |
| **1986** | | | | | |
| Sales to unaffiliated customers | $397,700 | $455,200 | $ 36,400 | $ — | $889,300 |
| Intersegment sales | 80,200 | 539,100 | 557,300 | (1,176,600) | — |
| Net sales | 477,900 | 994,300 | 593,700 | (1,176,600) | 889,300 |
| Income (loss) from operations | (81,700) | (19,300) | (4,100) | 2,500 | (102,600) |
| Interest expense, net | | | | | (28,100) |
| Other income | | | | | 7,000 |
| (Loss) before income taxes | | | | | (123,700) |
| Identifiable assets | 227,300 | 229,800 | 79,500 | (31,700) | 504,900 |
| Depreciation expense | 19,200 | 6,700 | 5,200 | — | 31,100 |
| Capital expenditures | 8,500 | 8,500 | 2,100 | — | 19,100 |
| **1985** | | | | | |
| Sales to unaffiliated customers | $375,500 | $468,700 | $ 38,900 | $ — | $883,100 |
| Intersegment sales | 57,600 | 556,700 | 691,300 | (1,305,600) | — |
| Net sales | 433,100 | 1,025,400 | 730,200 | (1,305,600) | 883,100 |
| Income (loss) from operations | (52,800) | (29,000) | 10,800 | (13,700) | (84,700) |
| Interest expense, net | | | | | (32,600) |
| Other expense | | | | | (7,300) |
| (Loss) before income taxes | | | | | (124,600) |
| Identifiable assets | 364,200 | 247,800 | 99,400 | (30,600) | 680,800 |
| Depreciation expense | 21,700 | 5,100 | 4,300 | — | 31,100 |
| Capital expenditures | 44,100 | 10,100 | 9,600 | — | 63,800 |

## 9 COMMITMENTS AND CONTINGENCIES

The Company and its subsidiaries are parties to a number of lawsuits. In the opinion of management, none of the lawsuits or claims should materially affect the consolidated financial position of the Company. In fiscal 1987 certain litigation relating to a claim by one plaintiff for compensatory and punitive damages in excess of $50 million was settled at no material cost to the Company.

In the United States and certain other countries, customs authorities have challenged the Company's classification of materials imported into the respective countries, resulting in claims for additional customs duties and/or penalties. In the opinion of management and counsel, the outcome of such claims should not materially affect the consolidated financial position of the Company.

## 10 QUARTERLY FINANCIAL INFORMATION (unaudited)

(000's omitted, except per share amounts)



| For the Year Ended 30 June 1987 | First | Second | Third | Fourth | Year |
|---|---|---|---|---|---|
| Net sales | $176,000 | $270,800 | $169,500 | $190,400 | $806,700 |
| Gross profit | 42,700 | 76,600 | 39,700 | 53,400 | 212,400 |
| Income before income taxes and extraordinary item | 5,200 | 23,800 | 1,000 | 2,400 | 32,400 |
| Income tax provision | 1,500 | 7,800 | — | 500 | 9,800 |
| Income before extraordinary item | 3,700 | 16,000 | 1,000 | 1,900 | 22,600 |
| Extraordinary item | — | 5,800 | — | 200 | 6,000 |
| Net income | $ 3,700 | $21,800 | $ 1,000 | $ 2,100 | $28,600 |
| Per share data: | | | | | |
| Income before extraordinary item | $ 0.12 | $ 0.50 | $ 0.03 | $ 0.06 | $ 0.71 |
| Extraordinary item | — | 0.18 | — | — | 0.18 |
| Net income | $ 0.12 | $ 0.68 | $ 0.03 | $ 0.06 | $ 0.89 |
| **For the Year Ended 30 June 1986** | | | | | |
| Net sales | $159,200 | $339,200 | $182,300 | $208,600 | $889,300 |
| Gross profit | 16,700 | 54,800 | 40,200 | 58,800 | 170,500 |
| Income (loss) before income taxes | (39,200) | (50,400) | (35,300) | 1,200 | (123,700) |
| Income tax provision | — | 2,800 | 1,400 | — | 4,200 |
| Net income (loss) | $ (39,200) | $ (53,200) | $ (36,700) | $ 1,200 | $ (127,900) |
| Per share data | $ (1.25) | $ (1.70) | $ (1.17) | $ 0.04 | $ (4.08) |

## AUDITORS' REPORT

To the Shareholders of Commodore International Limited:

We have examined the consolidated balance sheets of Commodore International Limited (a Bahamian corporation) and subsidiaries as of 30 June 1987 and 1986, and the related consolidated statements of operations, shareholders' equity and changes in financial position for each of the three years in the period ended 30 June 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 1 to the financial statements, the presence of certain factors, including significant net losses in the two-year period ended 30 June 1986, created an uncertainty as to the recoverability of the carrying amounts of the Company's assets and the classification of long-term debt. Accordingly, our opinion on the 1986 and 1985 financial statements was qualified as being subject to the effects of such adjustments, if any, as might have been required had the outcome of that uncertainty been known. Among other factors, and as further discussed in Note 1, the Company achieved net income of $28.6 million for the year ended 30 June 1987, and management has forecast continued successful operations. Accordingly, our present opinion on the 1986 and 1985 financial statements, as presented herein, is unqualified.

In our opinion, the financial statements referred to above present fairly the financial position of Commodore International Limited and subsidiaries as of 30 June 1987 and 1986, and the results of their operations and changes in their financial position for each of the three years in the period ended 30 June 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Philadelphia, PA
17 August 1987 (except with respect to the matter discussed in Note 5, as to which the date is 30 September 1987).

## CAPITAL STOCK INFORMATION

The Company's shares are listed on the New York Stock Exchange. The high and low quarterly common stock prices for the past two fiscal years were as follows:

| | **Fiscal 1987 High–Low** | Fiscal 1986 High–Low |
|---|---|---|
| First Quarter (30 September) | **$ 8 1/8–5** | $12 3/4–8 5/8 |
| Second Quarter (31 December) | **9 5/8–7 3/8** | 11 3/4–9 1/4 |
| Third Quarter (31 March) | **15 –9** | 11 3/8–4 7/8 |
| Fourth Quarter (30 June) | **12 3/4–8 7/8** | 9 1/4–6 1/8 |

## CORPORATE INFORMATION

### BOARD OF DIRECTORS

Irving Gould
Chairman of the Board

Burton Winberg
President
Rockport Holdings Limited

Ralph D. Seligman
Consultant Counsel
Graham, Thompson & Company

General Alexander M. Haig, Jr.
President of Worldwide Associates, Inc.
and Director of Leisure Technology, Inc.,
Allegheny International, Inc., and
Carteret Savings Bank, F.A.

Robert A. Utting
President
R.A. Utting and Associates, Inc.
Former Vice Chairman of the Royal Bank
of Canada



### OFFICERS

Irving Gould
Chairman of the Board
and Chief Executive Officer

Henri Rubin
Executive Vice President
and Chief Operating Officer

Richard Leberman
Vice President,
Chief Financial Officer and Treasurer

Joseph C. Benedetti
Vice President, General Counsel & Secretary

Harald Speyer
Vice President

Mikio Izumi
Vice President

David Spiers
Vice President

Thomas Matson
Vice President and Controller

Carden N. Welsh
Assistant Treasurer

Frances D. Moffitt
Assistant Secretary

### EXECUTIVE OFFICE

Commodore International Limited
1200 Wilson Drive
West Chester, Pennsylvania 19380

### REGISTERED OFFICE

Commodore International Limited
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Switzerland

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Commodore S.A.
Valencia 49
Barcelona, Spain

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Commodore Buromaschinen GmbH
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Ernst-Amme-Strasse 24-26
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West Germany

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Commodore Semiconductor Group
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### AUDITORS

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Philadelphia, Pennsylvania

### COUNSEL

Graham, Thompson & Company
Nassau, Bahamas

Kaye, Scholer, Fierman, Hays & Handler
New York, New York

### SHARES LISTED

New York Stock Exchange
(Ticker Symbol CBU)